United States Court of Appeals

for the Second Circuit

APPELLEE'S SUPPLEMENTAL BRIEF

76-7616

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

IN RE
FRANKLIN NATIONAL BANK SECURITIES
LITIGATION

ROBERT GOLD, et al.,

Plaintiffs-Appellants,

-against-

ERNST & ERNST, et al.,

Defendants-Appellees.

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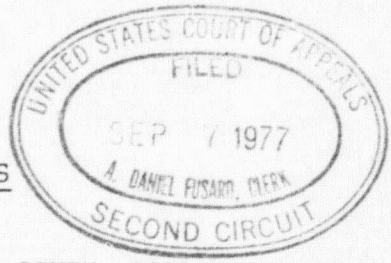

SUPPLEMENTAL BRIEF OF APPELLEES

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

IN RE FRANKLIN NATIONAL BANK SECURITIES LITIGATION	
ROBERT GOLD, et al., Plaintiffs-Appellants, -against- ERNST & ERNST, et al., Defendants-Appellees.	No. 76-7616

SUPPLEMENTAL BRIEF OF APPELLEES

This Supplemental Brief is submitted by defendants-appellees pursuant to this Court's order dated July 8, 1977, directing the parties to submit additional briefs discussing the impact on this case of Sanders v. Levy, No. 75-7608 (2d Cir. June 22, 1977) (en banc).[1/] Our position is that, on the facts of this case, the principles of law enunciated in Sanders v. Levy support affirmance of the order here appealed from.

1/ An earlier Supplemental Brief dated July 1, 1977 was filed by appellees and the amici curiae with the permission of the Court prior to the above order. This brief addresses new issues raised in Appellants' Supplemental Brief dated August 5, 1977 (hereinafter cited "Pl. Supp. Br.") and therefore supersedes our July 1 brief.

ARGUMENT

APPLYING THE TEACHING OF SANDERS V. LEVY TO THE FACTS OF THIS CASE, THE DISTRICT COURT DID NOT ABUSE ITS DISCRETION IN REQUIRING CLASS REPRESENTATIVES TO ADVANCE TO NON-PARTY BROKERS THE COST OF IDENTIFYING CLASS MEMBERS WHO HELD IN "STREET" NAME.

The question presented to this Court sitting en banc in Sanders v. Levy was

> "whether, under the Federal Rules of Civil Procedure, the district court was empowered to order a defendant at its own expense to cull from its computerized records the names and addresses of the members of the class represented by plaintiffs."

Slip op. at 4369. The Court answered that question in the affirmative and held that, on the particular facts before it, the District Court did not abuse its discretion in requiring the defendant mutual fund to bear that expense. Specifically, Sanders v. Levy held that (1) the computer-stored names and addresses of members of a class are "discoverable information" which may be obtained by the class representatives from a party defendant pursuant to Rule 34(a); (2) allocation of the cost of such production rests in the sound discretion of the district court; and (3) where the particular costs involved were necessitated by the defendants' proposed definition of the class, it was not an abuse of discretion to impose the cost on the party seeking the more inclusive definition. (Id. at 4373-74, 4377).

The question on this appeal is whether the District Court abused its discretion in refusing to require brokers who are not parties to this action to bear the costs of identifying class members whose securities were held in "street" name for the purpose of the individual notice required by Rule 23(c)(2). We respectfully submit that it did not, and that nothing in Sanders v. Levy requires a different result. The precise issues on which this case turns were not reached in Sanders, but the district court's decision is entirely consistent with the principles of law enunciated in that case.

The plaintiffs in the Sanders case were shareholders of defendant Oppenheimer Fund who sued its management, investment adviser and others, alleging both class and derivative claims. The fund was before the court as a party to the derivative claims, although it was not sued on the class claims. Plaintiffs originally sought to represent all persons who purchased shares of the fund during a 25-month period, including those who had subsequently sold. Identification of members of the class as so defined required creation of a special computer program, at a cost of approximately $16,000. In order to avoid this expense, plaintiffs sought to redefine the class to exclude purchasers who had subsequently sold their shares, and proposed to include the Rule 23(c)(2) class action notice in a regular mailing to current shareholders

of the fund. Defendants opposed the proposed redefinition of the class, both because it would limit the res judicata effect of the eventual judgment and because they wished to avoid the adverse effect of mailing the class action notice to current fund shareholders who were not members of the class. Adopting the broader class definition advocated by defendants, Judge Griesa ruled that the Fund must consequently bear the expense of identification necessary to permit individual notice to the members of the class as so defined, on the ground that "here the expense is relatively modest and it is defendants who are seeking to have the class defined in a manner which appears to require the additional expense." Sanders v. Levy, 20 F.R.Serv.2d 1218, 1221 (S.D.N.Y. 1975).

On appeal, a divided panel of this Court held that the cost of identification was part of the cost of notice which, following Eisen v. Carlisle & Jacquelin, 417 U.S. 156 (1974), could not be imposed upon the defendant fund, Sanders v. Levy, (2d Cir. June 30, 1976), slip op. at 4587-88.

On reconsideration en banc, a divided Court affirmed the allocation of the cost of identification to the defendant fund on the basis of Rule 34(a), Fed.R.Civ.P. Judge Hays, writing for the majority, relied specifically on the language of Rule 34(a) requiring a party to produce "documents (including . . . data compilations from which information can be ob-

tained, translated, if necessary, by the respondent through detection devices into reasonably usable form)," and the Advisory Committee Note interpreting this language as requiring "a print-out of computer data," slip op. at 4373-74, quoting F.R.Civ.P. 34(a) and Advisory Committee Note, 48 F.R.D. 459, 527 (1970).

A. SANDERS V. LEVY DEALT WITH DISCOVERY FROM PARTIES AND DID NOT CONSIDER IDENTIFICATION OF CLASS MEMBERS BY STRANGERS TO THE LITIGATION.

Rule 34(a) is inapplicable here, since it is by its terms expressly limited to discovery from parties. In 1970, when the "computer clause" relied on by Judge Hays was added, the draftsmen considered expanding the Rule to cover discovery against non-parties, but this alternative was expressly rejected because of the "very complex" jurisdictional and procedural problems involved, Advisory Committee Note, supra, 48 F.R.D. at 527. If discovery is to be used to obtain information as to class members' identities from non-parties, the applicable rule is Fed.R.Civ.P. 45(b), which provides:

> "(b) For Production of Documentary Evidence. A subpoena may also command the person to whom it is directed to produce the books, papers, documents, or tangible things designated therein; but the court, upon motion made promptly and in any event at or before the time specified in the subpoena for compliance therewith, may

> (1) quash or modify the subpoena if it is unreasonable and oppressive or (2) condition denial of the motion upon the advancement by the person in whose behalf the subpoena is issued of the reasonable cost of producing the books, papers, documents, or tangible things."

Rule 45(b) is conspicuously lacking in any provision for "transla[tion] . . . through detection devices into reasonably usable form" -- the precise language on which the Sanders decision was based and which Judge Hays found "especially tailored to the discovery problems posed by contemporary computer technology," slip op. at 4375.

Not only are non-parties not required to create new computer programs for the convenience of litigants, but Rule 45(b)(2) expressly provides that non-party witnesses may be reimbursed for the cost and expense of producing even ordinary business records, where justice so requires. The courts have consistently applied this clause to protect non-party witnesses from providing financial support for the quarrels of others, e.g., Novak v. General Electric Co., 10 F.R.Serv.2d 1177 (S.D.N.Y. 1967); accord, Celanese Corp. v. E.I. du Pont de Nemours & Co., 58 F.R.D. 606 (D.Del. 1973); Collins & Aikman Corp. v. J.P. Stevens & Co., 51 F.R.D. 219 (D.S.C. 1971); see generally 5A Moore, Federal Practice ¶45.05 (1975 ed.); 9 Wright & Miller,

Federal Practice and Procedure §2457 (1971).[2/]

Clearly, then, the provision of Rule 34 which the Court in Sanders applied to the defendant mutual fund provides no basis for requiring brokers who are strangers to this litigation to subsidize the giving of notice to class members whose stock was held in "street" name. The United States Court of Appeals for the Third Circuit so held in In re Penn Central Securities Litigation, No. 76-2139 (August 5, 1977), distinguishing Sanders v. Levy on precisely that ground.[3/] We respectfully submit that the same result is appropriate here.

In Penn Central, the district court entered an order, ex parte as to the brokers who held of record for members of the class, directing that notice be forwarded by the brokers

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2/ Plaintiffs' reliance on United States v. Int'l Business Machines Corp., 62 F.R.D. 507 (S.D.N.Y. 1974) (Pl. Supp. Br. 11), is misplaced, for in that case the court denied reimbursement to the subpoenaed non-parties on the ground that, although not joined in the action, they were "necessarily . . . most affected by the final judgment in this case," 62 F.R.D. at 510. No such finding can be made with respect to the brokers here, whose utter lack of involvement with this litigation is discussed in the brief of the amici curiae filed March 11, 1977. Plaintiffs also rely heavily on Blank v. Talley Industries, 54 F.R.D. 627 (S.D.N.Y. 1972) (Pl. Br. 11, 13), in which a broker's application for reimbursement of the $570 cost of responding to a Rule 45(b) subpoena calling for identification of class members was denied and Judge Gurfein stated that "I do not feel compelled in my discretion to pay the expenses," which he considered "in the nature of overhead expenses." The court's pointed emphasis on the discretionary character of the ruling makes clear that the Blank case cannot be stretched into a holding that brokers may never be compensated. The allowance of such compensation in the case at bar must therefore be judged on its own merits. Plaintiffs' discussion of the "relative burden" of such allowance (Pl. Supp. Br. 10-13) is fully dealt with in our main brief, filed March 11, 1977, pp. 37-38, and need not be repeated here.

3/ The Third Circuit's opinion, not yet reported, is reproduced as an Appendix to this brief, and is hereinafter cited "Op." followed by the orginal page number of the printed opinion.

to "street name" purchasers. After notice had been given, the brokers appeared at the hearing on the proposed settlement and applied for reimbursement of the amounts expended for identification of class members, as well as postage and copying costs. The district court denied the application, on the ground that the brokers should look to "the individual beneficial owners involved -- not the entire class." In re Penn Central Securities Litigation, 416 F. Supp. 907, 921 (E.D.Pa. 1976).

The Court of Appeals for the Third Circuit reversed. It held that the district court erred as a matter of law in imposing the cost of notice to beneficial owners upon the brokers, Op. at 14, and that such notices should be treated no differently from proxy solicitations and other communications from issuers to beneficial holders for which brokers are entitled to reimbursement (Op. at 8-11; see Appellees' Brief filed March 11, 1977, pp. 22-24). In so holding, the Court rejected plaintiffs' argument that the brokers could be required to identify the class members under Rule 34 on the ground that neither Rule 34 nor the en banc decision in Sanders v. Levy applying it reached the situation of non-party broker:

> ". . . [W]e have no occasion to address the issue (which so sharply divided the Second Circuit) of whether Rule 34 discovery is a method for avoiding some of the impact of the Supreme Court's holding in Eisen IV that the class representative

> must bear the initial cost of notice. We observe, however, that Sanders v. Levy dealt with a defendant and its record shareholders, not with Brokerage Houses who held Oppenheimer Fund shares in street name. The issues presented in the case sub judice has not been passed upon by the Second Circuit or any other."

The Court went on to reject as "strained" the argument that the brokers should be deemed "parties" by virtue of their membership in that class (Op. 13-14).[4/]

Plaintiffs do not argue that the precise issue here presented was determined by the court en banc in Sanders; their supplemental brief nowhere addresses the distinctions between imposing the costs of identification on parties and on non-parties such as brokers. Rather, their argument is that because Judge Platt, in the order appealed from, cited the panel's decision in Sanders, his decision was "wholly

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4/ Plaintiffs herein made that argument below (A213), but have not relied on it here. Should it be renewed in their reply brief in an effort to bring this case within the scope of Sanders, this Court should reject it for the same reasons the Third Circuit did. The concept of "discovery" by a class representative from members of the class he has volunteered to represent — at the expense of the class members — is an anomaly which points up the limitations in the usefulness of the discovery rules as authority for resolution of the problems of class action notice. Even where discovery of absent class members is sought by an adverse party, the courts have imposed strict limitations to protect the absent members from harassment, see, e.g., Robertson v. National Basketball Ass'n, 67 F.R.D. 691, 699-700 (S.D.N.Y. 1975); Wainwright v. Kraftco Corp., 54 F.R.D. 532 (N.D. Ga. 1972); Note, Requests for Information in Class Actions, 83 Yale L.J. 602 (1974). Our research has discovered no case requiring an absent class member to perform the kind of compilation and research here involved, and the Third Circuit's holding that Rule 34 "still applies only to parties in the conventional sense," In re Penn Central Securities Litigation, supra, Op. at 13, is supported by the Advisory Committee Note, 48 F.R.D. 487, 527 (1970), as well as by common sense.

determined" thereby and must be automatically reversed (Pl. Supp. Br. 5-7). This is a gross oversimplification.

Judge Platt, whose opinion is now reported, 73 F.R.D. 25, did indeed cite and discuss the panel's opinion in Sanders v. Levy. His decision, however, was squarely based on the single most important fact which clearly distinguishes this case from Sanders -- the fact that the brokers on whom plaintiffs seek to impose the costs of identification are not parties to this litigation. Citing the fact that the mutual fund in Sanders was a party to the derivative claims only, and had not been sued on the class claims, he concluded that

> "If anything, the facts in the case at bar present an a fortiori situation to the facts in the Sanders case because here the brokerage firms whose customers comprise a part of the class are not as involved as the mutual fund might be said to have been in the Sanders case."

73 F.R.D. at 27. The non-party brokers whose records are needed to identify class members here are in a completely different situation from the defendant mutual fund in Sanders, and the court had ample discretion to relieve them of the burden of financing the plaintiffs' suit.

B. NO QUESTION OF THE ADEQUACY OF NOTICE TO SATISFY DUE PROCESS WAS INVOLVED IN SANDERS.

There is an even more fundamental reason for distinguishing the procedures for discovery from parties applied in

Sanders v. Levy from the identification of class members by non-party brokers here at issue. The class representatives in their latest brief make clear that they have no intention of utilizing subpoenas pursuant to Rule 45(b) to obtain the names and addresses of class members. Despite the unequivocal language of the Court en banc in Sanders v. Levy reiterating the importance of individual notice to all identifiable members of the class,[5/] plaintiffs persist in arguing that their only obligation is to give notice to the brokers as record holders and leave essentially to chance whether it is ever forwarded to the members of the class who hold in "street" name (Pl. Supp. Br. 8-9). To say that identification of class members is governed by "discovery" from non-parties in such circumstances is a mockery. If plaintiffs merely send notice to the non-party brokers without making use of Rule 45(b), there can be no assurance that the notice will actually reach the members of the class, and consequently no assurance that notice will be constitutionally adequate to

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5/ "By mandating that a representative plaintiff in a class suit send individualized notice to the members of his class, Eisen raises as a potential issue in all such litigation whether the required notice has properly been sent. A list of the names and addresses of the class members would of course be essential to the resolution of that issue."

(Slip. op. at 4373, quoted in Pl. Supp. Br. at 4).

secure the res judicata effect of any judgment entered herein.[6/] In Sanders v. Levy, no such uncertainty was present: the production of a single computer printout by one party defendant was all that was needed to assure individual notice to all the members of the class. Consequently, the Court en banc was not required to, and did not, consider the adequacy of notice or the res judicata effect of the judgment on the class claims.

The holding of Sanders with respect to discovery from parties is thus of no assistance in solving the very real due process issue in this case, where discovery of the non-party brokers is not even contemplated by plaintiffs. Nor would the problem be solved if the class representatives did

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6/ Plaintiffs' argument that notice to record holders is sufficient was also advanced by the class representatives in the Penn Central case. The Court of Appeals for the Third Circuit held that that argument -- whether or not meritorious under other circumstances -- was simply not available where the district court had ordered (ex parte as to the brokers) that the notice be forwarded to the beneficial holders (Op. 8). The order here appealed from, which was also entered ex parte as to the brokers, expressly provides that

> "banks, brokerage firms, and other institutions holding record title as of any day from July 16, 1973 through and including May 16, 1974 to Franklin securities beneficially owned by others are required to forward this notice to the beneficial owners." (A274, ¶14)

This language was included at the request of plaintiffs (A54, ¶11) and was never in issue in the court below. Thus in this case, as in Penn Central, the argument that notice to brokers should suffice is foreclosed by the plaintiffs' own insistence that the Court direct notice to the beneficial owners.

The general subject of the adequacy of notice to assure the res judicata effect of any judgment herein is discussed in Appellees' March 11 brief, pp. 7-23.

a sudden about-face and determined to issue subpoenas pursuant to Rule 45(b) to the estimated 661 nominees who hold of record for "street name" purchasers (A288).

Unless the costs of identification are advanced at the outset, the time required to dispose of motions pursuant to Rule 45(b)(2) would necessarily result in delaying notice to the class, which has already been delayed more than a year by virtue of this appeal. Where the class members can only be identified from records of a large number of third parties, the situation is very different indeed from that involving a Rule 34 request to one defendant for a single computer printout,[7/] and discovery is simply not workable unless the costs are borne by the party seeking it. Cf. In re Sugar Industry Antitrust Litigation, 73 F.R.D. 322,

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7/ In most of the cases that have arisen thus far involving allocation of the costs of identification of class members, the relevant information has been in the possession of one or more defendants, so that imposition of costs on the producing party, where appropriate, has presented no procedural problems. The cases are collected in In re Nissan Motor Corp. Antitrust Litigation, 552 F.2d 1088, 1098-99, at note 11 (5th Cir. 1977). Nissan held that class representatives must advance the cost of identification as "part and parcel of rule 23(c)(2)'s mandate that the class members receive the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort," 552 F.2d at 1102, and rejected the argument that the discovery rules govern. Since the information necessary to identify the class members was in the possession of a party defendant, the decision is squarely in conflict with the rule enunciated in Sanders v. Levy on the issue of the applicability of the discovery rules, although the two decisions are in agreement with respect to the duty of class representatives to obtain that information for the purposes of notice. See the Supplemental Brief of the Amici Curiae dated September 7, 1977, pp. 6-7.

359 (E.D.Pa. 1976), where plaintiffs suing on behalf of thousands of retail grocery stores and industrial and institutional users of sugar were required, at their own expense, to obtain the names and addresses of class members from trade associations and other non-parties, and the court expressed particular concern that the notice be sent promptly.

C. SANDERS V. LEVY DEALT WITH DISCOVERY OF COMPUTERIZED INFORMATION, AND EXPRESSLY LEFT OPEN THE QUESTION OF ADVANCING THE COST OF IDENTIFICATION FROM "ORDINARY BUSINESS RECORDS."

In Sanders v. Levy, the names and addresses of all the members of the class were retrievable from a single computerized source. The Court sitting en banc found that this was precisely the situation to which the language of Rule 34(a) requiring "transla[tion] by the respondent . . . into reasonably usable form" was directed, and thus upheld the district court's order requiring the defendant fund to produce a computer printout of the names and addresses of the class members slip op. at 4373-75. At the same time, the Court was careful to note that

> "It may well be that where ordinary business records are concerned Rule 33 would generally require that the discovering party bear the expense of data compilation unless for special reason the compilation can be undertaken only by the respondent. However, Rule 33(c) cannot derogate from the general command of Rule 34 that the respondent to a demand for computerized information produce

> a 'reasonably usable' print-out of data contained in a computer's memory. Unlike Rule 34, Rule 33 was not especially tailored to the discovery problems posed by contemporary computer technology."

Id. at 4375 (emphasis added; footnote omitted).

In this case there is no basis for believing that all of the approximately 661 nominees from whom identities of class members must be sought maintain computer-stored records of this information. Where they do, the brokers' underlying stock record books are nevertheless an alternative souce of the same information (see A208), so that this case does not present the problem, which concerned Judge Hays in Sanders, of computers being used to "make information more difficult to discover." slip op. at 4375.

The problems involved in identifying class members from stock record books are not "problems posed by contemporary computer technology"; on the contrary, the task of manually copying their names and addresses can -- and should -- be readily performed by the discovering party.

D. THE DISTRICT COURT'S EXERCISE OF DISCRETION IN SANDERS WAS UPHELD ON THE BASIS OF OTHER FACTORS NOT PRESENT HERE.

Finally, the district judge's exercise of discretion affirmed by this Court in Sanders v. Levy was founded on material facts not present here. Judge Griesa relied primarily on the fact that the costs of identification at issue in Sanders were necessitated by the broader definition of the

class which defendants had urged, over plaintiffs' objection, 20 F. R. Serv.2d at 1221. This Court's holding en banc that the decision was not an abuse of discretion was squarely based on the same grounds, slip op. at 4377-78. No comparable facts are present here. The non-party nominees, to whom plaintiffs propose to shift the cost of identification of class members, have no interest in this litigation and no connection with the definition of the class. There is no basis whatsoever for holding that Judge Platt abused his discretion in imposing on plaintiffs the costs of identifying "street name" class members in the very different circumstances of this case.

CONCLUSION

In reviewing Judge Griesa's exercise of his discretion in allocating the costs of discovering the identity of class members in Sanders v. Levy, the Court sitting en banc emphasized that "there is no warrant for applying an inflexible rule that the discovering party bear the expense," slip op. at 4375. There is similarly no warrant for applying an inflexible rule that the discovering party be relieved of the expense. The one thing that is clear above all else on even the most superficial reading of Sanders v. Levy is that the only issue before this Court in reviewing allocation of the costs of identification is whether the district court abused its discretion.

Plaintiffs in their supplemental brief do not argue that Judge Platt abused his discretion in requiring them to advance the costs of identification in the first instance. Rather, they argue that "this Court should not treat the decision below as an exercise of discretion by Judge Platt analogous to that employed by a district judge in allocating discovery costs" because he did not cite the discovery rules in his opinion (Pl. Supp. Br. at 7). The issue, however, is not the style of Judge Platt's extremely succinct opinion, but whether the result was correct. Since the decision appealed from was expressly based on the fact that the brokers who must identify the members of the class are not parties to this litigation -- the principal fact which distinguishes this case from Sanders v. Levy -- that result was clearly correct and should be affirmed.

Dated: New York, New York
September 7, 1977

Respectfully submitted,

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APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 76-2139

IN RE: PENN CENTRAL SECURITIES LITIGATION

Shearson Hayden Stone Inc., Bache & Co., Inc., Drexel Burnham & Co., Inc., Loeb, Roades & Co., Paine, Webber, Jackson & Curtis Inc.. Wheat, First Securities Inc., Dean Witter & Co., Inc., E. F. Hutton & Co., Inc., Hornblower & Weeks-Hemphill, Noyes Incorporated, Merrill Lynch, Pierce, Fenner & Smith Inc., Reynolds Securities Inc., L. F. Rothschild & Co., and Thompson & McKinnon, Auchicloss Kohlmeyer Inc., Appellants

(D.C. MDL No. 56)

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Argued April 1, 1977

Before VAN DUSEN, GIBBONS and GARTH, *Circuit Judges*

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OPINION OF THE COURT

(Filed August 5, 1977)

GIBBONS, *Circuit Judge*

I

This is an appeal by Shearson Hayden Inc., Bache & Co., Inc., Drexel Burnham & Co., Inc., Loeb, Roades & Co., Paine, Webber, Jackson & Curtis Inc., Wheat, First Securities Inc., Dean Witter & Co., Inc., E. F. Hutton & Co., Inc., Hornblower & Weeks-Hemphill, Noyes Incorporated, Merrill Lynch, Pierce, Fenner & Smith Inc., Reynolds Securities Inc., L. F. Rothschild & Co. and Thompson & McKinnon, Auchicloss Kohlmeyer Inc. (the Brokerage Houses), from a final order of the United States District Court for the Eastern District of Pennsylvania denying the motion of the Brokerage Houses for reimbursement of

the costs they incurred in locating and sending class action settlement notices to the beneficial owners of stock held by the Brokerage Houses in street name [1] during a period relevant to the settlement. We reverse and remand for further proceedings.

The underlying class action grows out of the failure of the Penn Central Transporation Company. Following the filing of the Penn Central petition for reorganization in June of 1970 a number of suits were filed by stockholders of various companies affected by the reorganization, alleging various violations of federal securities laws and state common law fiduciary obligations. In June of 1971 the Judicial Panel on Multidistrict Litigation transferred all of these suits to the Eastern District of Pennsylvania. *See In re Penn Central Securities Litigation,* 322 F. Supp. 1021 (Jud. Pan. Mult. Lit. 1971); *In re Penn Central Securities Litigation,* 333 F. Supp. 382 (Jud. Pan. Mult. Lit. 1971). In 1973 the district court approved the stockholders' suits for class action treatment, defining five separate plaintiff class entities. The defendants thereafter negotiated a so-called "global settlement" with the class action representatives, calling for the payment of approximately $8.7 million to the five plaintiff classes, and the surrender by some defendants of shares of common and preferred stock in some of the affected corporations. The district court made an equitable division of the $8.7 million cash fund among the five classes. *See In Re Penn Central Securities Litigation,* 416 F. Supp. 907, 911, 912 (E.D. Pa. 1976).

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1. The holding of stock in street name refers to the practice whereby a brokerage house registers its name on securities left with it by its customers. Under this practice the brokerage house is known as the record holder of the stock and the actual purchaser of the stock is known as the beneficial owner. *See generally* SEC Street Name Study, Preliminary Report of Dec. 4, 1975, CCH Fed. Sec. L. Rep. No. 619, Part II, at 1-2 (December 11, 1975); Final Report of the Securities and Exchange Commission of the Practice of Recording the Ownership of Securities in the Records of the Issuer in Other Than the Name of the Beneficial Owner of such Securities Pursuant to Section 12(m) of the Securities Exchange Act of 1934, CCH Sec. L. Reps. No. 672, Part II (December 15, 1976) ("Street Name Study II").

On August 22, 1975, the district court, *ex parte* insofar as the Brokerage Houses are concerned, entered Post Settlement Order Numbers One and Two, which amended the definition of the plaintiff classes to include: (1) "[a]ll persons who between September 5, 1967, and June 21, 1970, bought, sold or held the common stock of the Penn Central Company, Pennsylvania Railroad Company or New York Central Company," and (2) "[a]ll persons who between January 1, 1965 and August 31, 1972, bought, sold or held the common stock of Great Southwest Corporation." The orders directed that, within ten days, the Brokerage Houses mail a "Notice and Proof of Claim Form" regarding the settlement to all persons in each defined class on whose behalf they had held stock in street name. The orders provided that the Brokerage Houses could reproduce copies of the Notice and Proof of Claim Form, or obtain copies of the Form from the district court, and that they would be reimbursed for "reasonable postage expenses incurred in connection with [the] mailing."

To comply with the district court's order, the Brokerage Houses individually performed research to identify and locate the stockholders whose shares they had held in street name during the relevant period, made sufficient copies of the Notice and Proof of Claim Form to send to those stockholders so located and identified, and mailed out the Forms to those stockholders. In so doing, the Brokerage Houses incurred aggregate costs for such research, copying and mailing totalling $24,106.03. Thereafter, each Brokerage House filed with the district court a Proof of Claim form seeking reimbursement out of the class settlement fund for their expenses. The Proof of Claim forms identify separately for each Brokerage House its copying costs, its mailing costs and its research costs. For each Brokerage House the largest expense item was its research costs, which involved a computerized search through old records for the names and addresses of stockholders included in the classes as defined in the district court's orders.

The notice form of the proposed settlements fixed November 3, 1975, for a hearing on the fairness and adequacy of the proposed settlements. At that hearing, attorney Philip M. Hammett entered an appearance on behalf of the Brokerage Houses and requested reimbursement on their behalf for their research, copying and mailing costs incurred in complying with the court's order of August 22, 1975. Though the district court heard argument on the Brokerage Houses' application for reimbursement, it did not rule on the application at that time. Instead, it suggested that the Brokerage Houses wait until the plaintiff-classes filed a motion for distribution of the settlement proceeds and, at that time, the Brokerage Houses file a motion to share in the distribution of the proceeds, which would then be considered by the court. Apparently, the Brokerage Houses' Proofs of Claim, referred to above, which were on file with the court, were viewed as complying with the court's suggestion that the Brokerage Houses file a motion to share in the distribution of the settlement proceeds.

On June 21, 1976, the district court, in a lengthy opinion devoted primarily to the issue of attorney's fees, ruled on the application of the Brokerage Houses for reimbursement of their mailing, copying and research expenses:

> Finally we come to the request of a number of brokerage houses for reimbursement of their costs in forwarding the class action notices to the beneficial owners of the stock involved. This is stock which the brokerage houses held in "street name."
>
> Nothing the brokers have pointed to in their brief convinces us that the class fund should bear the costs of forwarding the documents involved. Neither trade custom nor the inapposite holding of the Supreme Court in *Eisen IV, supra* at 179 overcomes the very obvious and common sense logic that if the brokers

> are to be reimbursed, it should come—if at all [38]—from the individual beneficial owners involved—not the entire class. There is simply no reason to require the entire class to pay for the choice of a few to have their stock held in street name.
>
> 38. We are not faced with, and do not decide, the obligation of the beneficial owner *vis a vis* the brokerage houses which held the stock in street name.

In Re Penn Central Securities Litigation, 416 F. Supp. 907, 921 (E.D. Pa. 1976) (footnote omitted). In a separate order accompanying its opinion the court states:

> "(32) The motion of Shearson, Hayden, Stone, Inc *et al* for reimbursement of costs is DENIED."

The effect of the order is to deny reimbursement both for the cost of research, and for the costs of reproduction and postage. No explanation is given for the inconsistency of the June 21, 1976 order with that of the August 22, 1975 order, which advised the Brokerage Houses that they would be reimbursed for "reasonable postage expenses."

II

In defending the district court's ruling, the plaintiff class representatives contend that the "reasonable effort" requirement for notice to the class set forth in Fed. R. Civ. P. 23(c)(2) [2] and elaborated upon by the Supreme Court in *Eisen v. Carlisle & Jacquelin,* 417 U.S. 156, 177 (1974) (*Eisen IV*), was met by (1) mailing individual copies of the Notice and Proof of Claim Form to all record owners of the stock (the Brokerage Houses), and (2) by providing the Brokerage Houses with the means of obtaining additional copies of the Forms for forwarding to the beneficial owners. From this they conclude that the court's *ex parte* order directing communication by the

2. Fed. R. Civ. P. 23(c)(2) provides in part:

> In any class action maintained under subdivision (b)(3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified *through reasonable effort.* (emphasis added).

Brokerage Houses with the beneficial owners was valid, and that the expenses incurred by the Brokerage Houses in complying with that order need not be reimbursed. But, even assuming arguendo the validity of the initial premise, the asserted conclusion does not necessarily follow. Had the court done no more than provide for notice to the record owners, the Brokerage Houses would be in an entirely different position. Each could have exercised its own independent judgment as to whether it had any legal obligation or business reason for undertaking the expense of providing individual notice of the settlement proceedings to the beneficial owners. Instead, the court, at the behest of the settling parties, ordered the Brokerage Houses to incur such expenses, even though the plaintiff class representatives now suggest that such an order was not required by Rule 23(c)(2).

The district court's reasoning is equally flawed in suggesting, as a reason for imposing the costs on the Brokerage Houses, that "[t]here is simply no reason to require the entire class to pay for the choice of a few to have their stock held in street name." 416 F. Supp. at 921. There may not be any reason to require the entire class, or anybody at all, to bear additional notice expense if notice to record owners would meet the requirements of Rule 23 (c)(2). But the fact remains that the court chose to direct that such notice be given. Evidently it saw some advantage in the procedure adopted. We suspect that the additional notice provision was insisted upon by the settling defendants out of an abundance of caution in order to be certain of the maximum judgment preclusion effect of the settlement. The interests of the settling defendants with respect to notice of the settlement proceedings is significant. The court's failure to appreciate the significance of that interest accounts, most likely, for its decision to place the expense of such notice on the Brokerage Houses, and not consider other alternatives. Assuming individualized notice to beneficial owners was either necessary or desirable, the cost could have been imposed (1) out of the

entire settlement fund, on the theory that more adequate notice gave the defendants greater safety and thus facilitated their willingness to enter into the settlement; (2) on the defendants (who might then have offered less) since the additional notice was primarily for their benefit; (3) out of that part of the settlement fund being paid to stockholders who had chosen to register their stock in street name, because their choice caused the additional expense; or (4) on the Brokerage Houses. In light of the court's summary treatment of the issue, only the last alternative appears to have been seriously considered.

It is no answer to the Brokerage Houses' objections that the district court "[did] not decide the obligation of the beneficial owner *vis a vis* the brokerages houses which held stock in street name." 416 F. Supp. at 21 n.38. The court did, by directing the mailing of the Notice and Proof of Claim Form, substantially alter the position of the Brokerage Houses and the beneficial owners. Had no such order been made, the Brokerage Houses would have been in the position of deciding themselves whether they should file proofs of claim on behalf of their former clients, obtain the settlement funds, and then seek reimbursement of their expenses from their customers as a pre-condition to release of the settlement funds. By the court's *ex parte* action they lost that option. Instead, the beneficial owners will file individual proofs of claim, and receive individual payments, and the Brokerage Houses will now have only the wholly illusory alternative of seeking individual reimbursements, from thousands of present and former customers, of sums which separately are insignificant, though collectively substantial.

The plaintiff class representatives answer this last objection by urging that, as a matter of law, the Brokerage Houses which have offered street name registration services to their customers should not be entitled, now or in the future, to any reimbursement of their notice costs. They urge that because the securities industry derives some benefits from the practice of holding shares in street

name, the cost of individualized notice to beneficial owners in class actions should be considered as a part of the industry's overhead expense. So to hold, however, would be to put class action notices in a favored position when compared with proxy solicitations, and would appear to be contrary to the industry practice. Securities and Exchange Commission Rule 14a-3(d), 17 C.F.R. § 240.14a-3(d) (1976), provides that an issuer shall upon request of a street name holder pay the reasonable expense of mailing proxy materials.[3] New York Stock Exchange Rule 451 (a)(2) qualifies a member organization's obligation to forward proxy materials upon assurance that the proxy solicitor shall reimburse the member organization "for all out-of-pocket expense, including clerical expenses, incurred . . . in connection with such solicitation." C.C.H. New York Stock Exchange Guide ¶ 2451 at p. 3805. The Rules of Fair Practice of the National Association of Securities Dealers, contains a similar rule.[4] S.E.C. Street Name

3. (d) If the issuer knows that securities of any class entitled to vote at a meeting with respect to which the issuer intends to solicit proxies, consents or authorization are held of record by a broker, dealer, bank or voting trustee, or their nominees, the issuer shall inquire of such record holder whether other persons are the beneficial owners of such securities and, if so, the number of copies of the proxy and other soliciting material and, in the case of an annual meeting at which directors are to be elected, the number of copies of the annual report to security holders, necessary to supply such material to such beneficial owners. The issuer shall supply such record holder with additional copies in such quantities, assembled in such form and at such a place, as the record holder may reasonably request in order to address and send one copy of each to each beneficial owner of securities so held and shall, upon the request of such record holder, pay its reasonable expenses for completing the mailing of such material to security holders to whom the material is sent.

17 C.F.R. § 240.14a-3(d) (1976).

4. Interpretation .05 of § 1, Art. II of the NASD Rules of Fair Practice entitled "Forwarding of Proxy and Other Material, provides in part:

FORWARDING OF PROXY AND OTHER MATERIALS

Introduction

.05 A member has an inherent duty in carrying out high standards of commercial honor and just and equitable principles of trade to forward all proxy material, annual reports, information statements and *other material required by law to be sent to* stockholders periodically, which are properly furnished to it by the issuer of the securities to each beneficial owner of shares to that issue which are held by the member for the beneficial owner thereof. For the assistance and guidance of members in meeting their responsibilities, therefore the Board of Governors has promulgated this

Study II, pointing to the importance of the street name practice in facilitating clearance and settlement of securities transactions, observes that 84 percent of the brokers participating in the study sought reimbursement for forwarding notices to beneficial owners of shares held in street name.[5] The study suggests no change in the industry practice in this respect.

A reason for treating class action notices differently from proxy solicitations, the plaintiff class representatives suggest, is that imposing the added cost of notice resulting from the street name practice upon class action plaintiffs may impede the effectiveness of the class action as a device for the vindication of the rights of the small investor. There are several answers to this contention. One is that

4. (Cont'd.)

interpretation. The provisions hereof shall be followed by all members and failure to do so shall constitute conduct inconsistent with high standards of commercial honor and just and equitable principles of trade in violation of Article III, Section 1 of the Rules of Fair Practice of the Association.

Interpretation

Section 1. No member shall give a proxy to vote stock which is registered in its name, except as required or permitted under the provisions of Section 2 or 3 hereof, unless such member is the beneficial owner of such stock.

Section 2. Whenever a person soliciting proxies shall timely furnish to a member

(1) sufficient copies of all soliciting material which such person is sending to registered holders, and

(2) satisfactory assurance that he will reimburse such member for all out-of-pocket expenses, including reasonable clerical expenses incurred by such member in connection with such solicitation, such member shall transmit promptly to each beneficial owner of stock of such issuer which is in its possession or control and registered in a name other than the name of the beneficial owner all such material furnished.

* * *

Section 4. A member when so requested by an issuer and upon being furnished with:

(1) sufficient copies of annual reports information statements *or other material required by law to* be sent to stockholders periodically, and

(2) *satisfactory assurance that it will be reimbursed by such issuer for all out-of-pocket expenses, including reasonable clerical expenses,* shall transmit promptly to each beneficial owner of stock of such issuer which is in its possession and control and registered in a name other than the name of the beneficial owner all such material furnished.

C.C.H. NASD Manual ¶ 2151, at p. 2038-3-39.

5. See note 1 *supra*, Street Name Study II at 21 Section (f).

the competing policies of encouraging class action litigation on behalf of small claimants, and of requiring class representatives to shoulder the initial cost of notice, were weighed by the Supreme Court in *Eisen IV*. There, the Court did not rule on the precise problem presented by the street name practice, but in concluding that the class representative had to bear the cost of notice in the first instance, it rejected an interpretation of Rule 23 generally favorable to the facilitation of class action lawsuits. But an answer more directly on point with this case, is that we are dealing not with the minimum notice required by *Eisen IV*, in order for the class action to initially proceed, but with an additional notice, concerning proposed settlements. No persuasive argument has been made that the Brokerage Houses should be made to bear the additional expense of facilitating settlements; or indeed, that of the several alternatives for allocation of the street name notice costs, that chosen by the district court will be any more likely than the others to facilitate the future use of the class action device.

Finally, the plaintiff class representatives urge that Fed. R. Civ. P. 34 [6] provides authority for the imposition

6. *Rule 34. Production of Documents and Things and Entry Upon Land for Inspection and Other Purposes*

(a) Scope. Any party may serve on any other party a request (1) to produce and permit the party making the request, or someone acting on his behalf, to inspect and copy, any designated documents (including writings, drawings, graphs, charts, photographs, phono-records, and other data compilations from which information can be obtained, translated, if necessary, by the respondent through detection devices into reasonably usable form), or to inspect and copy, test, or sample any tangible things which constitute or contain matters within the scope of Rule 26(b) and which are in the possession, custody or control of the party upon whom the request is served; or (2) to permit entry upon designated land or other property in the possession or control of the party upon whom the request is served for the purpose of inspection and measuring, surveying, photographing, testing or sampling the property or any designated object or operation thereon, within the scope of Rule 26(b).

(b) Procedure. The request may, without leave of court, be served upon the plaintiff after commencement of the action and upon any other party with or after service of the summons and complaint upon that party. The request shall set forth the items to be inspected either by individual item or by category, and describe each item and category with reasonable particularity. The request shall specify a reasonable time, place, and manner of making the inspection and performing the related acts.

on the Brokerage Houses of the cost of giving settlement notice to the class. In support of this position they rely on the recent *in banc* decision in *Sanders v. Levy,* Civ. Nos. 75-7608, 75-7610, 75-7611 (2d Cir., filed June 22, 1977). In that case a divided court held that Oppenheimer Fund, Inc., a defendant in a class action suit, could be compelled under Rule 34 to retrieve from its computerized records the names and addresses of over 100,000 of its own shareholders who had purchased their shares during the relevant class period and were members of the proposed class. The court held that although design and use of a computer retrieval program to cull out those names would cost the defendant $16,000, those names and addresses were a proper subject matter of discovery, and the district court did not abuse its discretion under Fed. R. Civ. P. 26(c) in declining to shift that expense to the plaintiff class representatives. The court left open the possibility that the defendant could recover the $16,000 as costs taxed against the plaintiffs if they proved to be unsuccessful in the suit.

Reliance on Rule 34, and on *Sanders v. Levy,* is misplaced. Rule 34 and the holding in *Sanders v. Levy* is limited only to "parties" to the suit in question. The plaintiff class representatives urge, however, that the Brokerage Houses should, in this case, be treated as parties, since as street name record owners they were theoretically members of the plaintiff class. Entirely aside

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The party upon whom the request is served shall serve a written response within 30 days after the service of the request, except that a defendant may serve a response within 45 days after service of the summons and complaint upon that defendant. The court may allow a shorter or longer time. The response shall state, with respect to each item or category, that inspection and related activities will be permitted as requested, unless the request is objected to, in which event the reasons for objection shall be stated. If objection is made to part of an item or category, the part shall be specified. The party submitting the request may move for an order under Rule 37(a) with respect to any objection to or other failure to respond to the request or any part thereof, or any failure to permit inspection as requested.

(c) Persons not parties. This rule does not preclude an independent action against a person not a party for production of documents and things and permission to enter upon land.

As amended Mar. 30, 1970, eff. July 1, 1970.

Fed. R. Civ. P. 34.

from the fact that the court order for notice to the beneficial owners in effect put the street name record owners outside the class and substituted the beneficial owners, we think that such a construction of the term "party" in Rule 34 would be strained. The Advisory Committee Note on the 1970 revision to Rule 34 makes clear that although the revision makes information in computer memory storage discoverable, the Rule still applies only to parties in the conventional sense.

> *Subdivision (c).* Rule 34 as revised continues to apply only to parties. Comments from the bar make clear that in the preparation of cases for trial it is occasionally necessary to enter land or inspect large tangible things in the possession of a person not a party, and that some courts have dismissed independent actions in the nature of bills in equity for such discovery on the ground that Rule 34 is preemptive. While an ideal solution to this problem is to provide for discovery against persons not parties in Rule 34, both the jurisdictional and procedural problems are very complex. For the present, this subdivision makes clear that Rule 34 does not preclude independent actions for discovery against persons not parties.

Advisory Committee Note, 48 F.R.D. 487, 527 (1970). Other discovery methods against third parties are available, but were not resorted to in this case. Moreover, even if we were to accept the strained argument which would treat the Brokerage Houses as conventional parties, Rule 34 still would not help, for unlike *Sanders v. Levy,* there was in this case no compliance with the procedural requirements of Rule 34(b). The district court did not purport to act under Rule 34(b) in making its August 22, 1975 *ex parte* order.

Since Rule 34 was not involved in this case in the district court we have no occasion to address the issue (which so sharply divided the Second Circuit) of whether

Rule 34 discovery is a method for avoiding some of the impact of the Supreme Court's holding in *Eisen IV* that the class representative must bear the initial cost of notice. We observe, however, that *Sanders v. Levy* dealt with a defendant and its record shareholders, not with Brokerage Houses who held Oppenheimer Fund shares in street name. The issue presented in the case *sub judice* has not been passed upon by the Second Circuit or any other.

This case involves no more than the $24,106.03 which the Brokerage Houses incurred in compliance with the August 22, 1975 *ex parte* order. We are aware, however, that both sides have in mind larger stakes. If we were to accept the argument of the plaintiff class representatives that, in Rule 23(b)(3) class actions, the cost of individualized notice to beneficial rather than record owners should be borne by the securities industry, the industry would not collapse. Probably, however, the securities industry would, in determining its future charges, attempt to anticipate the cost of such notice, and pass it on across the board to customers who avail themselves of street name registration. Thus, in a broad sense, the choice that th plaintiffs class representatives are urging on us is that all future beneficial owners of securities held in street name bear the cost of notice to those among them who purchase securities which become involved in class action litigation.[7] Certainly, an alternative, if settling defendants insist on notice to beneficial owners, and if class representatives do not bargain for those defendants to bear the added expense, would be to assess the cost against that part of the settlement fund being paid to those shareholders who during the relevant time chose to leave their holdings in street name. Another alternative would be to assess the added cost against the entire settlement fund if the district court were to conclude that the added notice fa-

7. Brokers, could, theroetically, contract with customers individually for reimbursement of class action notices, even after the customer relationship ended. That alternative while possible, seems unlikely and impracticable when compared to a simple across the board cost increase.

cilitated the overall settlement. In this case, however, we hold only that the district court erred as a matter of law in imposing the cost of notice to the beneficial owners upon the Brokerage Houses. Given that the expense of notice has already been incurred, it will be for the district court on remand to determine what fund, other than monies from the pockets of the Brokerage Houses, must bear this cost.

The order denying the motion of the Brokerage Houses for reimbursement of the cost of sending notice to the beneficial owners of street name securities will be reversed, and the case remanded to the district court for further proceedings consistent with this opinion.

A True Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit.

(A.O.—U. S. Courts, International Printing Co., Phila., Pa.)

CERTIFICATE OF SERVICE

I hereby certify that on September 7, 1977 on behalf of defendant Howard D. Crosse I caused two true copies of the within Supplemental Brief of Appellees to be served by U.S. mail, postage prepaid, upon each of the following:

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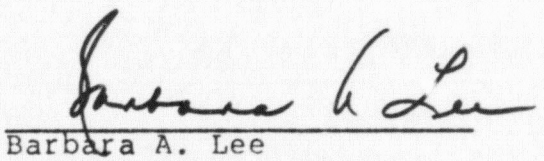

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